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Event Transcript

WAVX - Q2 2003 Wave Systems Corporation Earnings Conference Call

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Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Wave Systems Corporation second-quarter results conference call. During the presentation, all participants will be in a listen-only mode. Afterwards we will conduct a question-and-answer session. (OPERATOR INSTRUCTIONS) As a reminder, this conference is being recorded Thursday, August 14, 2003. I would now like to turn the conference over to Steven Sprague, Chief Executive Officer with Wave Systems Corporation.

Steven Sprague

Thank you very much. Good afternoon, everybody. This is Steven Sprague. I will just warn everybody ahead of time that I'm in New York City on this conference call and our building has lost power, as I guess a number of other buildings in New York have lost power, so our phone system is on a backup battery support. And so if the phone system goes dead, then we'll have to figure how to reschedule this call at some later date. But anyway, as long as the power remains on, we will continue. With that I would like to turn it over to Jerry Feeney who will review the quarterly numbers and then we'll go through the current status of where we are. Thank you very much and, Jerry.

Gerard Feeney

Thanks. At 4:00 PM this afternoon we released our financial results for the second-quarter. These can be found on our website at Wave.com. We've reported net revenue of \$34,000 for the second quarter ended June 30th. This compares to \$78,000 for the prior year. Revenues for both periods were principally related to service and license contracts. For the second quarter we reported a net loss of \$6,274,000 which represents 12 cents per share. This compares to \$9,687,000 or 19 cents per share for last year. Let's see, as of June 30, 2003, Wave had working capital of \$4 million. This includes a note receivable from a former officer which totaled approximately \$1 million. During the period we also received \$2.6 million in proceeds from exercise of employee stock options and this brings our total cash to about \$7.6 million. If you read the press release you'll find out more about our ongoing events as well as reports for the quarter. (indiscernible) with time running out, Steven, let me pass this back to you.

Steven Sprague

Thank you, Jerry. What I'd like to do is just start with a couple of things. One is that we really, I think, have had tremendous momentum increase during the course of the last period of time. As many people know, Wave has been focused on how we bring our technology into the PC platform, and how we help to enable the trusted computing marketplace. And we're working very hard to enable a number of applications on these platforms so that it's easy to use and deploy a trusted computing platform right out of the box. For those people who aren't that familiar with trusted computing, the real basis of trusted computing is a new chip that's going onto motherboards that in shorthand is referred to as a TPM. And this is a chip that is built today by Atmel, by National Semiconductor and by Infineon. And today Wave has built marketing relationships and business relationships with all three of those companies and we're working to either jointly market or bundle our services.

In the case of National we're bundling our services, in the case of the other two companies we have marketing alliances with them where we're actively in joint sales calls and promoting the use of our applications in connection with their technology that we've tested it, that we've made sure that they work correctly, and we're actively in the marketplace with them. We are working to enable these applications on the first trusted computing platforms that come into the marketplace so that when the user comes and purchases one of these machines, they're able to turn it on and use it right out of the box, to do a range of initially fairly simple applications, and we think these are the early applications that end-users and business customers will need, and we look forward to developing a much broader array of services leveraging the infrastructure that Wave has built around its EMBASSY technology.

So we have, in the course the last few weeks, I think everybody has seen the announcement that we did with Intel and the announcement that we did with IBM, and we're very pleased to be working with both of those companies and we're very excited about the opportunities that they offer us, and we think there really is tremendous opportunity in the marketplace for the trusted computing space. From -- I'm sorry, it's a little distracting here. From a business perspective, let me step back and articulate where our business model is and how we can realize the revenue from this market opportunity. So, Wave is focused on really two aspects of revenue. The first is a bundled service revenue, and this is the case where we provide this collection of applications and we provide some basic services and we're paid on a per unit shipped basis, and it's revenue that

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we realize on every unit that's shipped. That includes our technology.

The second aspect of our business model is really built around a services model, and those services are the services to provide the tools to manage the lifecycle of a trusted computing platform. And these services are things like how do I get a credential? How do I move that platform from one machine to another? How do I back up a platform? So simple examples are I go out and get a new trusted computer and I want to move my life from one machine to another. How do I effectively transition all of the keys and relationships and business applications that I have on one machine and move them to a second machine? And these really are the services that Wave is focused on.

From a business perspective, we believe the market will start generating revenue for us really the end of this year in fourth-quarter, although I think the bulk of that revenue won't really be realized till a quarter after because it takes some time for those numbers to be reported back to us that this revenue is based primarily on the applications that are bundled with the platform, very much around a relationship that we've announced with Intel and the business model that was articulated in that press release. In the case of the ongoing services, we believe as the market develops to have a broader number of consumers and end-users who have the technology in hand, then their demand for additional applications to help manage their platform we think will increase. And we think Wave is very well positioned to not only license technology to large businesses, but also provide services to smaller businesses in the marketplace to take advantage of trusted computing.

And in order to understand the scope of this market, I think it helps to understand how trusted computing can be used in the market. And we really see the opportunity for, whether it's a small business or a large business, to take advantage of the tools in a trusted computer to dramatically enhance the security of their users and of their networks. So simple applications like just authentication, it now makes it possible for me to use a trusted computer to log onto my e-mail over a wireless connection at a Starbucks and feel completely confident that my user identity is secure over that relationship, and that I can go collect my e-mail in a manner that, even though I'm using a public network, I have a very secure communication back to my corporation. Or if I have a website that has restricted access, for example, it's my pricing list for my company's products, I can go there and log into that and know that only the people who are authenticated salespeople are able to get into service.

So we think they're a range of applications that are very useful, very important to business today and applications that everyone uses everyday. So we think this is a technology that has really good legs under it and will be very broadly distributed. As we think of the volume side of this business, (technical difficulty) have expressed their plans to ship platforms the end of this year, and we believe we'll develop quite strongly in 2004. I think the real challenge in creating predictions is how fast is that market going to ultimately grow? We believe that the market will broadly adopt trusted computing across all platforms. The question is, is it going to take three years or five years or seven years? I think we're banking that it's a much shorter period of time, because this is an inexpensive technology. It's very easy to integrate in platforms, and it's a technology that provides real value to the user of the platform out of the box.

We also believe that today consumers -- and I use consumers in sort of the broadest context -- really end-users on a PCI have real demand for security and see it as a market. They need the technology to continue to expand what they're doing. So from Wave's perspective, our task has been how do we touch as many of the trusted computing platforms as possible? How do we build relationships with those leading companies in the market that are driving this technology forward? And ultimately, how do we then offer services to those platforms? So today we have, as I've said before, bundled the technology with a number of the silicon manufacturers, we're now moving upstream to build relationships and make sure that our technology is completely compatible with the large manufacturers' implementations. Therefore our increasing announcement with IBM's ISV program where they've certified our technology and ensured that it works against our platform.

We think that the interoperability testing is one of the real value ads for Wave in the market. We've worked very hard to ensure that our applications function not only on one specific implementation but the full panacea of implementations in the marketplace, and we think that will really help us continue to broaden our touch across as many platforms as possible. And we believe our job is to help add value in the early stages of this market so that we can be in the box in front of as broad an array of customers as possible, and then have the opportunity for an ongoing services relationship and deliver the value that we believe our aftermarket services will add to the marketplace. We have worked very hard with our partners to help move the industry forward, and I think Wave is generally considered one of the companies that has its head down and is pushing really hard to make sure that trusted computing is implemented, is available broadly, has some good services out of the box, and

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we're definitely being recognized for that work that we've put in.

It's taken a long time to get this underway. We've been building these relationships for a number of years and it's been really great to realize the benefit of the announcement that we made with Intel, our relationship with IBM, and to see that the larger players in the market are recognizing that Wave has quality technology, that we have it available in the market in a timely manner, that we're doing our job well and that they're comfortable in working with us. And we really look forward to supporting them in the market and making them ultimately successful in their goal of bringing a greater level of trust and security to the end-users of the PC market. Wave has also spent some time working in the government marketplace, and we have a number of applications against our EMBASSY Smart Card technology. This is an EMBASSY Smart Card reader that contains our own silicon which is a programmable security chip.

We recently did a deal with Cubic Defense Applications. They're going to integrate EMBASSY in some of their next generation Smart Card Readers. We see this as a very positive application, they have strong relationships in the government, and we're very enthusiastic to be working with cubic and have them to select our technology in the market. And we also made an announcement earlier in the quarter with Techsec. Techsec provides a number of technologies that enable differential access to documents and other information. So depending on which Smart Card is plugged into a reader, you're allowed to view the administrator's view or a specific user's view, and there are a number of applications for the Techset technology in homeland security, in different training applications, etc. We continue also to work with a number of federal and state opportunities in secure input and different identity card technologies.

Recently Northrop Grumman showed a presentation that included Wave as part of the solution for the DISYS technology and we look forward to continuing to work with them to help build some of that cross credentialing technology for different identities. We also continue to pursue a number of opportunities outside the U.S. with the Smart Card reader and are continuing to make progress on that front. I'd also like to talk briefly about WaveXpress. WaveXpress is a subsidiary of Wave Systems. It was originally a joint venture between ourselves and Sarnoff. We announced today a relationship with Colle+McVoy who selected our technology to use WaveXpress as part of marketing and advertising relationships that they have with a number of very large customers in the marketplace. We're really excited to see how that technology can be used.

I think we did a very nice implementation with Howard Dean presidential campaign to do Howard Dean TV. They've quite successfully used -- we have over 5,000 subscribers to that service now that are actively using it as almost their own closed caption, or closed-circuit television system to their 5,000 plus supporters who have put it on their broadband connection. And we have a very good relationship with a group in Europe called Europe Online who are broadly using it in the satellite system. They have a number of subscribers today. But actually the WaveXpress signal is now available pretty much throughout all of Europe. So a consumer at home with a satellite dish can buy a now under \$80 card and load it into their PC and get WaveXpress via satellite in Europe. So we're pleased with that relationship.

We hope that it will continue to develop into a broader revenue opportunity in the market. And we're quite excited to show that there are some strong enterprise applications very similar to how Howard Dean is using our technology to communicate. We think there's a really opportunity for training and distance learning and a number of communications applications using the WaveXpress technology. So in summary, we really think the pieces are coming together quite strongly. We have good I think relationships with the industry leaders in the marketplace. They're driving forward with our technology. We're helping them to achieve their goals. And I think if we continue to do a good job, keep our heads down, drive forward, the Wave team has been doing a fantastic job in supporting these customers and delivering our products on the schedules we promise, and we're very excited about the opportunities that are there.

We think the long-term scope in that business is tremendous and on a short-term basis we think we can reach the point where the company gets to cash flow breakeven sometime in 2004. We fundamentally believe that the trusted computing market has got a very strong future, that there's very strong backing for it, and that the medium and long-term growth potential is quite tremendous. Our task is to have as broad a penetration into that as possible and I think we're really executing very well on our plan to touch as broad a share of the market today as we can. And I think we've been very pleased with how the market has responded to the technology. So the company has now access to the resources that we need in order to operate, the recent exercise of options which brought in additional cash was something that really helped to strengthen our balance sheet. We continue to work towards strengthening the overall company, and the ultimate way to do that is to drive the revenue base so this company reaches a cash flow breakeven position and we think that's very achievable in 2004.

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So with that, I'm going to stop my prepared comments and let people ask some questions. (technical difficulty) I think all the shareholders will appreciate the fact that we're sitting in an air-conditioned office in New York and it continually gets hotter and hotter here. It's probably gone up about 10 degrees since we started this call, so we can answer questions for as long as we can or until the heat gets unbearable. Anyway, thank you very much.

+++q-and-a

Operator

(OPERATOR INSTRUCTIONS) John Stuart of National Media.

John Stuart

I have to apologize. We worked together to make sure the heat rose and that the pressure was raised so that the answers would be good. Just teasing. Here's two questions that I have. The burn rate does not seem to be going down. We kept hearing it was going to come down, it's going to come down. I'm not seeing it, but I'm not an expert. Is the burn rate coming down?

Steven Sprague

Yes, the burn rate has actually dropped pretty significantly. We were at above \$1.5 million per quarter at the beginning of the year. We're done around \$1.2 million a quarter (multiple speakers)

John Stuart

Per month?

Steven Sprague

Yes. Sorry, \$1.2 million a month.

John Stuart

(multiple speakers) 6.2 for the quarter, \$6.2 million for the quarter?

Steven Sprague

Right, so we've made some very significant steps in that direction. I think the company's pretty lean at this point, and we've been trying to maintain the balance between how do we make sure we satisfy our large customers in the market, they have tremendous demands, and at the same time make sure we're as lean as possible so that we have as much resource as possible. I think we have a very good balance on that. We've been able to execute well, we've been able to deliver our products on time. That's very important in this marketplace. And yet we are also comfortable that we have more than sufficient runway to get to where we want to go.

John Stuart

So my infamous question is of leaving the lights on till all this happens, you feel like you're well -- you're much more comfortable now than you were, say, four months ago? That we're going to have the resources and the wherewithall to keep the lights on until this unfolds?

Steven Sprague

Very much so. The real challenge in this market has been when are the first units going to ship with scope and volume, and I think that we're beginning to be able to show that in the marketplace. We certainly had a clearer view in it for the last couple of quarters, so we've been much more comfortable than perhaps our shareholders can be because it's hard to see the data that we have. But we're very comfortable. This is a market that begins to ship in fourth quarter, that we have the resources to get there, that that will ultimately drive (technical difficulty) skill, it's what you would consider the average adoption by the PC industry. We feel quite comfortable (technical difficulty) you can't get from zero to 100 million units without having some scale to it early on.

John Stuart

Well, thanks a lot.

Steven Sprague

Thank you.

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Operator

Ronald Mayor of R.E.M. financial.

Ronald Mayor

With all this recent flurry of good news, I'm having some difficulty in understanding what it all means and in particular how everyone involved receives the revenue. As an example, the Atmel announcement today appears different than the bundling arrangement with MSN, and the Intel motherboard arrangement seems to be another variation of how Wave receives revenue. Could you explain how the participants in these arrangements share in the revenue streams? In other words, how will the payments be structured?

Steven Sprague

So in some cases we're just a supplier, so we supply a license to certain technology and we get paid, and that's the case in both National and Intel. We supply them with a product, they pay us for the product and they pay us on a per unit basis. In other cases, it's more of a marketing partnership where we're going together to the market and we're either just selling alongside them to the end customer or we're selling through them and they're acting as a reseller to the customer. Both models are contemplated. This is fairly early on in the market process to completely define the terms of how everybody is going to divide the revenue. We have slightly different models with different players in the marketplace because they've requested it to function that way, and we're quite comfortable with that. We think there is definite demand for the type of product we're providing.

And we believe the demand will ultimately develop for the services model because at the end of the day we think you're going to want to be able to call an 800 number if you lose your laptop and help get your keys recovered, and you need somebody to call, you don't want to call 100 different service providers. You want to be able to talk to your IT department if you're a large organization, or you want to be able to call the service provider if you're a small organization and you've outsourced that capability.

Ronald Mayor

So you can't really say right now how the pie is cut in terms of who gets what?

Steven Sprague

Well, what I can say is that today in the software deals that we've done, it's a simple software licensing deal. We supply them with a copy of software, they bundle it in their platform, we get paid. In the case of services, it's our business model. So it will follow an appropriate channel distribution business model where members of the channel get compensated in their normal way and rates and Wave collects its services. It's possible for those to be direct, to be through channel partners, and to be bundled on a wholesale basis. So we anticipate that all of those models are available to us. It's very hard today to give you any prediction on we think this percentage of our revenue will result from this specific piece of business model.

Ronald Mayor

Okay, that leads (multiple speakers) unclarity about the distinction or the differentiation between the pan (ph) services versus the often quoted \$30 per year per seat for premium service. Can you clarify what the difference is between those?

Steven Sprague

So there's some -- to a certain extent probably a little bit of confusion there between Wave's EMBASSY platform technology where we're providing a chip and the trust services that manage that chip and those are the trust assurance network services. In the case of EMBASSY services that we're providing to the trusted platform, we see those as in essence premium -- utility is probably not the right word to use here, but premium applications that provide lifecycle management for that platform. So the goal is that the \$25 to \$35 per year per seat model for an end-user to have their machine managed, that's a retail pricing. The same type of model could be available -- is available where we will sell a server to a large organization, pick a big company, a General Electric, where you could sell a server to a General Electric and then it's a server license plus a much lower per seat license.

Ronald Mayor

Last question, (technical difficulty) with all this great news about the EMBASSY Trust Suite and (technical difficulty) the HIPAA compliance, the health insurance portability act, and maybe comment on the Puerto Rico project and its implications to the health care industry?

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Steven Sprague

So there are a number of places that we have taken the EMBASSY Smart Card Reader technology in the government. And there are places where it has tremendous applicability. In the case with Puerto Rico, we're doing fingerprint comparison on the EMBASSY device which ensures the integrity and privacy of biometric analysis. We're doing a number of things in government in connection with the common access card or their Smart Card identity program where EMBASSY provides a more intelligent Smart Card Reader and a more secure infrastructure, and that level of flexibility offers the customer, in this case a number of different government agencies a variety of ways they can use the technology. The same is true for HIPAA compliance. It's actually many of the same kind of applications where an EMBASSY device provides the platform for additional services so I don't have to buy as expensive a Smart Card. I can buy a cheaper Smart Card and a more expensive reader, which in many cases is a much more economical model and a much higher performance model.

So we're making really good progress on that front. The government is clearly moving forward in their security spending. The new budget cycle happens in October. We've got a number of projects that we're involved in. I'm quite pleased with the progress that's going on there, but there's no question, the core focus of the Company is in the area of the trusted computing platform. And I think that what we're doing with EMBASSY 2100 and doing application level security will be very important to the future of where trusted computing goes and has been very important for us to develop what we have so far to support the existing trusted computing architecture. So it gives us an opportunity to have technology we can support today and a pretty good view of where the technology should be in a couple of years time, and the ability to invest in that with real customers, helping us to understand what their needs and demands are.

So it's a very (technical difficulty) and to drive that forward, because it gives us a good picture of how I think trusted computing will evolve and where it with ultimately end up, which is in a more application model as opposed to a key management model, (technical difficulty)

Ronald Mayor

(technical difficulty) hardware. Thank you.

Operator

John Lewis with (indiscernible) Capital.

John Lewis

(technical difficulty) What was the guidance for revenue to get you to that breakeven number in 2004?

Steven Sprague

I haven't been really specific on the numbers for that. What I can say is that the market begins to engage in fourth-quarter in volume with a number of different platforms. We expect to realize revenue from shipments in fourth-quarter and first-quarter. Because it'll take some time to realize -- for the process to flowthrough as to how many units shipped, etc., and get your royalty check actually mailed to you.

John Lewis

Could you touch on the -- did you give any color on the Intel deal and what that could mean for revenues?

Steven Sprague

So Intel hasn't been specific about what their volumes are in the market and I'll let Intel answer ultimately that volume question. We receive a fee on a per motherboard basis. There are no minimums in the contract and there are no maximums in the contract. They decide what products they put it on and how many products they put it on. And we ultimately believe that trusted computing is a very important space for them and for others. So as long as we do a good job and we deliver our product and it works and it's a quality product and delivered on time, (multiple speakers) broadened out across their platform. So it's just premature to answer the question (multiple speakers) in that when they start shipping next month's numbers hopefully will be larger than the previous month's numbers.

John Lewis

Got it. Is it an exclusive with Intel?

Steven Sprague

No, it's not an exclusive with Intel. We are a supplier to them. It's a very standard PC OEM industry contract. We built

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something they think is currently cool, they can replace it when they decide they want to replace it with something else. They can use it as broadly as they want or as little as they want.

John Lewis

Okay, understood. And then lastly, I saw you guys did cut your cash burn I believe from 6 million to 4 million this quarter. Can you give us any color on what you're doing to raise additional capital, or -- I don't know if you touched on that? I joined a little late.

Steven Sprague

We raised capital back in April. We had some recent employee option exercises. We have an active S3 registration that's in process. We'll evaluate how we want to approach any additional capital raised post that S3 coming effective. We recognize certainly, as I think everybody does, that the recent volume in the stock and action in the stock has certainly given us greater access to capital today than we had in the first and second (multiple speakers) quarter. So not only do we have a stronger cash position on the balance sheet today, we have a clear view on where the customer is going to ship. But I think we have pretty broad access to capital. We continue to have a number of plans where we have a number of assets within the Company that we've been actively pursuing to leverage into the marketplace, and we'll continue to evaluate that and try to make the best decision for the shareholder's value.

John Lewis

Can you give any color on the IBM deal in terms of what that means for revenues?

Steven Sprague

IBM shipped multiple millions of units of TPM platforms in the market, and what we've done is we have certified our technology in a manner that it works against their independent software program, and we're now engaged with them to develop those programs with them to reach out and offer this type of application base to their customers, which (multiple speakers) do independently and we can do jointly with them.

John Lewis

Is theirs similar to the Intel deal in that you can work with them, but it's open if you wanted (multiple speakers)

Steven Sprague

In some ways it's very different. Intel is a customer who has purchased a license to certain software that they have the right to bundle, and they can decide what platforms it goes on and what specific services they want to bundle or not bundle. In the case of IBM, it's an Independent Software Vendor program where what we have done is certify. They've taken our software, tested it, said yes, this does what it says it does. It uses a TPM properly. It works with the IBM platform. So we can then go offer it as an improved supplier to IBM to customers who've purchased TPM platforms, both IBM platforms, although ultimately this will work on any of the TPM platforms.

John Lewis

Okay, got it. And last I just want to get one more question if I could. On the cash, You say you raised 3.5 million through the exercise of options. So your cash I guess I'd estimate as of today is around \$5 million? Is that -- (multiple speakers)

Steven Sprague

We announced that we ended last quarter with 4 million and we've added to that an additional 2.6 million in cash, plus another one from the (multiple speakers) of a -- plus one for a repayment of an officer loan.

John Lewis

Right, but should we assume (indiscernible) the same cash burn from Q2 to Q3 would be about (multiple speakers)

Steven Sprague

We continue to make steps to bring the cash burn down. I think that we're at a point today where we're going to hold it pretty steady-state. And I think we're at a team that's very lean, but very capable of delivering and driving this market forward. So we're at a really good balancing point at this point in time. And our ability to deploy and yet also have as much runway in front of us as we need.

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John Lewis

So does that runway extend through Q4 or is that (multiple speakers)

Steven Sprague

We're pretty comfortable we have access to cash through the end of the year and I think there are pretty clear plans on the table that will drive that significantly beyond that. So the Company then I think is in a very strong position at this point in time. Yes, we have still to execute on things. There's no question about that, right? But we can clearly, clearly see the path in the marketplace, the path to the product shipping, the path to revenue, the path to additional capital, both in things that we're doing internally as well as opportunities in the public market. And so I'm very comfortable that we have the tools we need to realize the opportunity we've put in front of ourselves. And the team's doing a fantastic job on executing and delivering what we've promised, and ultimately that will show in the revenue numbers.

John Lewis

Can I get one or -- do you have time for one more question?

Steven Sprague

Yes, one more question, sure.

John Lewis

Just in the patents, I think you guys have 10 patents, is that right so far?

Steven Sprague

That's approximately correct, yes.

John Lewis

And I think the CEO owns the rights to those patent, is that right?

Steven Sprague

(technical difficulty) one patent that was created at the foundation of the Company in the data broadcasting market that is owned by Peter Sprague but all of its rights and capabilities have been licensed back to the Corporation. And if royalties were to have resulted from the patent, which today no royalties have, then there's a small royalty paid back to Peter, the original founder of that patent. But all other patent at Wave are owned by Wave 100 percent. We do have a couple of licensed patents, but those aren't patents you'd consider as owned property by Wave.

John Lewis

But those can be licensed to any other company as well, right?

Steven Sprague

Absolutely (multiple speakers) free title, we can do whatever we want, you can sell it, etc. The data broadcasting patent functions as though it was owned by Wave, but it does pay a small royalty to Peter.

John Lewis

Can Peter license that to any other Company or is it just (multiple speakers)

Steven Sprague

No, we have (multiple speakers) exclusive to it. And just for clarity for anybody else, that patent royalty on that is listed in the 10-K, but I believe it's 1.5 percent of royalties received. Anyway, for the next question.

Operator

David Stein with (indiscernible) Value Fund.

David Stein

I have a question. I was reading through the 10-K and it said that -- and you confirmed on the call -- that you won't have sufficient -- you don't anticipate having sufficient revenue to fund operations beyond the first quarter of '04, and that you anticipate needing about \$7.9 million from a combination of revenue and other sources for the 12 month period ending June

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30th. My question is, can you at all give any kind of color to the ratio of what that 7. million will look like between revenue and other streams of income, whether it be private placement or something else? I'm just trying to get a sense for how much revenue will really be part of that by June 30th.

Steven Sprague

So if I could clarify a little bit, the 7.9 is today's current expense plan, and we haven't released what our internal forecasts are. But to cover the expenses it would be 7.9. You could have that much in revenue, but what we're trying to say in the press is one way or the other, whether it's through revenue or reduction of expenses or private placements or the sale, as an example, of our SSP shares which are marketed at \$4.5 million today, there are lots of different ways to cover that 7.9 of forecasted expense. So that's not a net number after what's forecasted for revenue. That's actually the gross number for expense.

David Stein

I understand that. What I'm trying to get at is what do you anticipate the amount or percentage of that 7.9 million will be revenue by that point in time?

Steven Sprague

I think I can help provide clarity to this. So as I said before, we think the sort of driving revenue of the Company starts in fourth quarter, that you'll see the actual recognition of the beginnings of that (technical difficulty) revenue in first quarter of next year. It's our hope that in calendar 2004 we reach a point of cash flow breakeven for the Corporation. So we think the scale of the trusted computing market has the capacity to do that. We today are projecting that, but at the same time I think that the ability to project that with really good clarity will start in fourth quarter and first quarter because you'll have at least some indication of the pace with which the PC industry (technical difficulty) So I want to be careful in taking what are my aggregated forecasts from the PC industry and just multiplying times my revenue per unit, because it could be a higher number than that, it could be a lower number than that.

I do feel comfortable that once the industry begins to ship the platform, that it should generally grow quarter on quarter on a volume basis, unless some outside force interacts with it. This is a technology that delivers really good value and if IBM is any indication in how they've modeled their shipments, they've kind

of gone to a model which says this isn't an optional technology, this is something we're putting on a specific line of machines and it goes across the entire line. And that's most likely because it's an inexpensive enough technology that it's too expensive to maintain a unit with security and a unit without. It's cheaper to just build security across the line. So hopefully others will follow that same kind of lead and see the market driving forward and broadly place us in their platform.

I think what's interesting is at the end of the day if you're a business user and you go out there and have a choice, and you have a choice between a laptop with security, and a laptop without security, and the delta in retail price is \$20 or \$25 bucks, what are you going to choose? And in answer that question yourself, I think you can help to indicate how broadly is this kind of technology going to be received in the marketplace?

David Stein

But again, getting back to the revenue question, at this point you can't even ballpark what meaningful amount of the 7.9 million will come through revenue. So at this point really it may come in, obviously sequentially it's going to be more first quarter than fourth quarter, that's obvious. But in terms of being a meaningful number, you don't know whether it will be second quarter, second half, or the 7.9 million. The majority of it is going to have to be raised through accessing the public markets?

Steven Sprague

I think my general sense, this is how I was trying to answer it is that, clearly it's going to start and then grow on a quarter by quarter basis. So in fourth quarter it will be a small piece. In first quarter it will be a larger piece, etc. Our goal certainly would be by middle of next year to get to cash flow breakeven, which would mean that you're at 1 million, 1.2 million per month kind of run rate. It's hard today to say that as a definitive statement when you can't see through to is this a technology that the PC OEMs are going to ship on 5,000 units or 500,000 units? And because it's across a broad array of players, their capacity to go from zero to very fast once a technology has been tested and integrated is really good. So if people have success with this, this could get very big very fast. If it rolls really slowly it can take a couple of years to get deployed. And there are many good indicators in the marketplace to go look at as to the adoption of different technologies in the PC industry and see what their rates are, and it's been as fast as 24 months to go from zero to every machine has one on it, and it's been as slow as six

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or seven years from machines to go from zero to everything on it.

David Stein

Steve, I don't mean to really put you on the spot here, but (technical difficulty) in the stock and certainly the share price, you exercised options for 150,000 shares, had a strike price of \$2.01, and also your CFO sold 100,000 shares. What message do you think that sends to shareholders, because I was disappointed quite honestly to see that?

Steven Sprague

So let me explain what my decision process was on that. (technical difficulty) and it became very clear as a number of employees exercised options that the message ran around Wave that an employee exercised options -- exercising options was benefiting the corporation. And this is not a message that was propagated by management. This is a message that came up through the troops at Wave. And you can see that there were options that were exercised that ranged from \$1 to \$4. So an option (technical difficulty) exercised at \$4 on basically a minimal delusional basis generated very significant cash for the company. We are in a substantially stronger position today because of employee stock option exercises.

The additional \$3 million that that generated or \$2.5 million that that generated for the company I think is going to make a huge difference in the types of options that are available to us. And as a CEO (multiple speakers) I felt that it was appropriate to be able to say to my employees that if they went and exercised options and therefore gave up some of the long-term value, because we believe in this thing, that it's appropriate for me to do some of the same. So don't want to be in a position where I can just say hey, I'm the only person who didn't. So I think that the message was here's an opportunity for the employees of the company to exercise some options and help the company achieve being in a much stronger position, and this is a transaction that of course all of us could do without taking any time in a market that was highly liquid, so I don't think we had really any effect on the share price, and we are in a phenomenally stronger position today because of an additional 2.6 million in cash.

David Stein

You missed the point of my question. It wasn't the exercising of the options, which of course helped put some needed money into the coffers of the company. It's the fact that you immediately sold the underlying shares.

Steven Sprague

I learned this lesson the hard way. I exercised and held options. Used to do that. Never again. I had a \$280,000 AMT tax bill in 2000, and I have a mortgage on my house because of the \$280,000 AMT tax bill, and I have friends who pretty much got close to going bankrupt because of AMT. So I learned by lesson and I learned it the hard way. And the reality is you don't want to get into a situation where you wrote the option exercise check and so not only do I have to spend money for the options but then I've got to go pay the tax bill on the differential and this is nuts. So if I exercised options and didn't immediately sell them, first off my wife would shoot me, and it's been a real challenge for a lot of our employees in the marketplace.

David Stein

You could've waited for the -- obviously the stock is a lot higher now and it doesn't -- to try to entice other people to buy this stock when it's at \$3.50 when you sold it at \$2 isn't a great incentive. That's my only point. (multiple speakers)

Steven Sprague

(multiple speakers) My motivation was very much the specific issue of if we could help generate cash for the organization it was absolutely the right thing to do and I have room to move right now because we did this and it helped signal to other employees that it was comfortable to do this, and it really helped us in the market. So there are other times when I can say that people have sold stock where they made a decision one way or another, and I can agree with you. This time, this cash was incredibly valued to you as a shareholder because it gives me choice.

David Stein

Did I hear -- I might have not heard this correctly. Did you say you were generating or expected at some point to generate \$20 million in gross margins?

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Steven Sprague

I don't think I said that.

David Stein

I apologize for that. And last question, if I may, what does your technology do better or differently than any number of scramblers that are out there on the marketplace?

Steven Sprague

I really appreciate the question. This is really important in the marketplace. Let's understand what happened in the market because Trusted Computing deploys. For the first time, there is a secure and safe place where you can put a, for example, credential that says I'm allowed into my corporate network, or I can go get my e-mail. I don't need a token, I don't need a Smart Card, I don't need some badge, I don't need anything. My laptop for the first time can connect to the service on the internet that's being offered. In many aspects if you think of the world at large, all networks have this except the computing network. So cellphones are connected to the cellphone network have security so that you can't clone a phone. If you remember back to the early days of the cellphone business, there were no security chips in phones and fraud was a big problem.

Today you pick up your phone, you dial the number, you get connected, it works every time. You lose your phone, you call Verizon up and say give me a new phone. You get your old number on the phone, your old phone gets killed and it works great. So why can't my machine manage all my relationships with services and I log into my machine? So that technology is the core driver of trusted computing. To make that technology easy to manage and deploy there are a range of different services and applications that we as end-users would like to have. I want to be able to back my machine up.

And so I can go down to the store, buy a new laptop, if I've lost my computer I can recover my life because it's all of my relationships to different services and different trusted workgroups and different payment systems, etc. And you don't want to have to go re-establish each one of those relationships with every single vendor and marketplace or every single business that you do business with. You want to be able to push a button and have your machine recovered and be able to continue on. Those are the types of services that Wave is building.

David Stein

Can you very -- is one million Intel chips at 1.5, is that about the price, or 2 million chips at a dollar? Do you have the pricing yet?

Steven Sprague

What we've said about pricing is we're not supplying a chip, we're supplying software to Intel that they're allowed to bundle with their motherboards or they're licensed to bundle with their motherboards. And our general product pricing, this is not specific to the Intel contract, is in the 50 cents to \$1.50 per seat basis. That's true of National, Intel, etc. (multiple speakers)

David Stein

And no minimum, no maximum?

Steven Sprague

Correct. This is very standard in the PC business.

David Stein

Thank you for your time.

Steven Sprague

You're very welcome.

Operator

Jeff Kitchen (ph) with Oppenheimer & Co.

Jeff Kitchen

Hi, Steven. You just said 50 cents to \$1.50 on the Intel pieces. Can you talk a little bit about pricing for the nonbundled services and then specifically I saw something on your website about a \$39.00 package that's available tomorrow.

Steven Sprague

Yes, so we have a software application that you can order off the internet, we'll then send you a CD, it's actually not directly

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downloadable yet, that you can get this collection of applications. If you have either an HP platform or an IBM platform it will run against a standard TPM in the marketplace. So that in essence is a software package which represents the same software suite that we're bundling with National, with Intel, with other OEMs potentially in the marketplace. That suite of applications you can buy from us, and it has a retail price point of \$39.95. The ongoing services are not yet commercially available to end-users. We are in the beginning conversations with a number of business customers to offer them on a pilot basis, and they'll roll out more broadly later on in the year. And those are typically a per seat per year service model, and that will obviously change whether you're licensing an enterprise server and the enterprise is going to run it, or it's a service provider model for a smaller business and it's something that either Wave or one of our partners would run.

Jeff Kitchen

Separately, can you give any color as to who's supplying the TPMs for the Intel motherboards?

Steven Sprague

I'll leave that to Intel to announce. That's really not for me to say.

Jeff Kitchen

And this last thing, any color on the cable industry? I know that you guys had been fairly close on a few things. Can you give an update there?

Steven Sprague

We have a number of really good relationships on the cable side. We continue to oscillate between something's going to happen tomorrow and something's going to happen in a couple quarters. It's -- we have a very strong technology in cable. I think one of the things we've very effectively done over the course of the last couple of months is broaden the application to both broadband DSL providers and some of the satellite providers. The implementation that we've done in Europe is actually quite interesting. Today's signal radiates 90 million dishes in Europe. What it really needs is some marketing muscle behind it. It's not for us to do. We're just a technology provider to Europe online who actually runs the service, but they offer satellite service over Eutelsat and the signal covers from Great

Britain all the way about halfway across Moscow all the way down to -- down to the Middle East and up through Norway, etc.

So that's a pretty big footprint and most everybody you has a satellite dish points it at Eutelsat gets the signal. So all you have to do is buy a \$70 card, plug it in your PC, and you get signal. So we'd love to see them broaden their marketing relationships because it's time to go push that service with greater force, but that's to them. We're not going to try to do that in the consumer market ourselves. We're happy to supply them with the services and technology we provide them.

Jeff Kitchen

Thanks.

Operator

Walt Paulson, private investor.

Walt Paulson

Hi, Steven. I have a quick question on IBM. The installed base is around 4 million machines I understand for TPMs. Is that installed base of 4 million, are all of them capable of working with the \$39.99 package that will be made available tomorrow?

Steven Sprague

Yes.

Walt Paulson

Okay. And the second question is, as additional services eventually come into the market next year, or later this year, or at some point in the future, and you've stated before that Wave won't be alone in having services for TPMs, how can Wave -- can you explain how as additional services from other companies enter the fray at some point, good thing or bad thing for Wave? I know your (indiscernible) station services are very important in all this. Can you explain how that might be beneficial in any way to Wave?

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Steven Sprague

I think a good way to think of this is in two ways. There are two types of services, an application service, so let's take an example, a firewall vendor wants to put certificates on a TPM. And in that case, they just want to use other tools to do that. They don't want to have to worry about how do I manage those, how do I back them up, how do I recover them. They just want to use the trusted computing infrastructure and not have to think about all the details of trusted computing. In that case, that's hugely beneficial to Wave because we want to do all that heavy lifting work to actually make the trusted computing platform work, and be easy to manage for an enterprise for their business users. And let the application vendors tie into that. That's very cool.

The place we have not yet seen any significant competition is in the context of are there other companies trying to build the same thing Wave's building, which is the infrastructure to manage and help deploy and make it easy for a business to adopt trusted computing and use it broadly within the solutions that they offer. And there I think that ultimately there's room for a number of vendors. I think we're clearly first in the market. We're the only ones that I know of that have demonstrated a service today, and we enjoy being first in the marketplace on that. We are I think very well prepared for competition in that space. We have tremendous technology and investment in building that, and we have the years that we've spent in building our EMBASSY infrastructure that we've been applying to managing these kinds of services that give us a pretty good understanding of how we think we can execute in this space.

Walt Paulson

Okay, thank you very much.

Steven Sprague

Thank you.

Operator

(OPERATOR INSTRUCTIONS)

Steven Sprague

If we've consumed all the questions, let's rap it up.

Operator

There are no further questions.

Steven Sprague

Thank you very much for your time. It's gotten pleasantly hot here in New York. And I certainly thank you all for your support and thank the Wave team for what they've done over the course of the last quarter. They've really performed very well and we look forward to talking to you next quarter. Thank you very much.

Operator

Ladies and gentlemen, that does conclude your conference call for today. We thank you for your participation and ask that you please disconnect your lines.

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